FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | PROPERTY | INDUSTRIAL PROPERTY

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Property For Industry
FY19 — I Guess That's Why They Call it Industrial Property

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NEUTRAL

Property For Industry (PFI) has reported its FY19 result close to expectations, highlighted by a strong NTA lift. There was little in the way of earnings surprise apart from a small boost in adjusted funds from operations due to lower maintenance capex. PFI is well placed as a defensive yield play with its Auckland industrial assets and track record. NEUTRAL.

NZX Code	PFI
Share price	NZ$2.50
Target price	NZ$2.15
Risk rating	Low
Issued shares	498.7m
Market cap	NZ$1,247m
Avg daily turnover	257.5k (NZ$582k)

Financials: Dec/	19A	20E	21E	22E
NPAT* (NZ$m)	42.6	43.8	43.7	44.5
EPS* (NZc)	8.5	8.8	8.8	8.9
EPS growth* (%)	1.9	2.8	-0.1	1.9
DPS (NZc)	7.6	7.7	7.8	7.9
Imputation (%)	100	100	100	100

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	22.1	22.2	22.0	21.6
EV/EBIT	22.1	22.2	22.0	21.6
PE	29.3	28.5	28.5	28.0
Price / NTA	1.2	1.2	1.2	1.1
Cash div yld (%)	3.0	3.1	3.1	3.1
Gross div yld (%)	4.3	4.4	4.5	4.5

Steady FY19 Earnings and modest dividend growth guidance

PFI has reported an FY19 result close to expectations with no surprises. FY19 distributable profit per share was 8.5cps and in line with our forecast of 8.60cps, with underlying rental growth of ~5% pa across its rent reviews. The 4Q19 dividend was 2.15cps, bringing the FY19 dividend to 7.60cps (versus 7.55cps in FY18), in line with guidance and a 98% pay-out of PFI's calculated adjusted funds from operations (AFFO). As was the case with 1H19, AFFO was boosted slightly by a lower maintenance capex assumption of 25 basis points versus 35 in the pcp. Funds from operations (FFO) were up +2.6% at 9.07cps and AFFO was up +4.4% to 7.79cps in line with expectations. PFI expects the FY20 dividend to lift from 7.60cps to the range of 7.76–7.7cps (+0.6% to +1.3%) and to be covered by AFFO. The 4Q dividend record date is 2 February and payment on 4 March 2020. We have not changed our forecasts. Our target price lifted to NZ$2.15 supported by the NTA lift and rolling forward our DCF.

NTA lifted to NZ$2.06

The previously reported FY19 final revaluation was a gain of +9.3% which has increased the NTA to NZ$2.06 (+15.6%), up from NZ $1.77 in FY18. One third of the uplift was rental growth with the portfolio ~6% under-rented. The cap rate firmed from 6.21% to 5.75% and while the outlook from here looks flat in terms of further rate compression, high prices for keenly sought industrial assets continue to be set in Auckland. The total portfolio is 94 properties with a book value of NZ$1,476m. The balance sheet is solid at 28% geared, well below the 50% covenant. Gearing will move to ~33% with capital commitments and to ~27% following the divestment of remaining non-core properties, which remains a key near-term goal.

Portfolio theory

Occupancy remains at 99%, WALT is steady versus the pcp at 5.38 years, and the portfolio weighting to Auckland (84%) and industrial property (90%) increased slightly over the year. Lease expiry in FY20 and FY21 of 6.5% and 6.6% remains manageable.

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Property for Industry Ltd (PFI)

Priced as at 17 Feb 2020 (NZ$)	**2.50**

12-month target price (NZ$)*	**2.15**
Expected share price return	-14.0%
Net dividend yield	3.1%
Estimated 12-month return	-10.9%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.70
WACC	5.3%
Terminal growth	1.5%

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	76.1	79.8	80.4	81.5	82.9
Normalised EBITDA	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Net interest	(18.8)	(19.0)	(19.0)	(19.4)	(19.4)
Associate income	0	0	0	0	0
Tax	(10.9)	(13.1)	(12.1)	(12.2)	(12.7)
Minority interests	0	0	0	0	0
Normalised NPAT	**41.8**	**42.6**	**43.8**	**43.7**	**44.5**
Abnormals/other	68.3	133.7	20.4	18.5	18.8
Reported NPAT	**110.1**	**176.3**	**64.2**	**62.3**	**63.4**
Normalised EPS (cps)	8.4	8.5	8.8	8.8	8.9
DPS (cps)	7.6	7.6	7.7	7.8	7.9

Growth Rates	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (%)	7.7	4.9	0.8	1.3	1.7
EBITDA (%)	10.1	4.6	0.2	0.7	1.8
EBIT (%)	10.1	4.6	0.2	0.7	1.8
Normalised NPAT (%)	12.5	1.9	2.8	-0.1	1.9
Normalised EPS (%)	3.7	1.9	2.8	-0.1	1.9
Ordinary DPS (%)	1.3	0.7	1.3	1.3	0.6

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Working capital change	1.6	1.7	0.2	0.3	0.4
Interest & tax paid	(19.2)	(28.1)	(31.1)	(31.6)	(32.1)
Other	0	0	0	0	0
Operating cash flow	**53.7**	**48.4**	**43.9**	**44.0**	**44.9**
Capital expenditure	(14.8)	(16.1)	(5.2)	(5.3)	(5.4)
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0
Other	(0.1)	0.7	0	0	0
Funding available/(required)	**10.6**	**22.8**	**38.7**	**38.7**	**39.5**
Dividends paid	(37.9)	(37.7)	(38.2)	(38.7)	(38.9)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**(27.3)**	**(14.9)**	**0.6**	**0.0**	**0.6**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(9.2)	(7.2)	(7.2)	(7.3)	(7.5)
Fixed assets	1,318.7	1,469.3	1,489.0	1,512.9	1,537.1
Intangibles	29.1	29.1	29.1	29.1	29.1
Right of use asset	0	0	0	0	0
Other assets	5.0	13.8	13.8	13.8	13.8
Total funds employed	**1,343.5**	**1,505.0**	**1,524.7**	**1,548.4**	**1,572.5**
Net debt/(cash)	396.6	411.8	411.2	411.2	410.5
Lease liability	0	0	0	0	0
Other liabilities	35.1	46.1	46.2	46.4	46.6
Shareholder's funds	911.8	1,047.1	1,067.3	1,090.9	1,115.4
Minority interests	0	0	0	0	0
Total funding sources	**1,343.5**	**1,505.0**	**1,524.7**	**1,548.4**	**1,572.5**

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Spot valuations (NZ$)	
1. DCF	1.99
2. NAV	2.06
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	1,472
(Net debt)/cash	(412)
Less: Capitalised operating leases	0
Value of equity	1,054

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	22.8	22.1	22.2	22.0	21.6
EV/EBIT (x)	22.8	22.1	22.2	22.0	21.6
PE (x)	29.8	29.3	28.5	28.5	28.0
Price/NTA (x)	1.4	1.2	1.2	1.2	1.1
Free cash flow yield (%)	3.1	2.6	3.1	3.1	3.2
Net dividend yield (%)	3.0	3.0	3.1	3.1	3.1
Gross dividend yield (%)	4.3	4.3	4.4	4.5	4.5

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	3.8	3.9	3.9	3.9	4.0
Interest cover EBITDA (x)	3.8	3.9	3.9	3.9	4.0
Net debt/ND+E (%)	30.3	28.2	27.8	27.4	26.9
Net debt/EBITDA (x)	5.6	5.5	5.5	5.5	5.4

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	5.3	4.9	4.9	4.8	4.8
Return on equity (%)	4.6	4.1	4.1	4.0	4.0
Return on funds employed (%)	4.4	4.1	3.9	3.9	3.9
EBITDA margin (%)	93.9	93.6	93.0	92.5	92.5
EBIT margin (%)	93.9	93.6	93.0	92.5	92.5
Capex to sales (%)	19.5	20.1	6.5	6.5	6.5
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	90	89	88	89	88

Property Statistics	**2015A**	**2016A**	**2017A**	**2018A**	**2019A**
Major Prop. Values - PFI (NZ$m)					
7-9 Niall Burgess Rd, Mt Wellington	27.3	28.9	31.0	32.0	43.5
54 Carbine Rd, Mt Wellington	22.4	25.8	26.4	28.6	33.0
6 Donner Place, Mt Wellington	14.5	15.0	15.1	15.1	24.8
686 Rosebank Rd, Avondale	32.2	33.4	35.0	40.0	44.5
212 Cavendish Drive, Manukau	17.1	19.1	22.4	29.7	29.7
3-5 Niall Burgess Rd, Mt Wellington	15.7	17.3	17.7	20.0	21.0
30-32 Bowden Rd, Mt Wellington	20.7	21.4	25.4	27.0	27.8
Major Prop. Values - DPF (NZ$m)					
Carlaw Commerical, Parnell	60.8	61.8	62.1	63.8	72.0
Carlaw Gateway, Parnell	33.8	35.0	35.0	35.5	34.4
78 Springs Road, East Tamaki	72.0	78.5	82.8	83.0	95.0
229 Dairy Flat Highway, Albany	22.9	24.7	27.0	28.0	
15 Jomac Place, Avondale	21.0	23.6	24.0	24.5	25.1
Portfolio Summary					
Investment properties (NZ$m)	987	1,083	1,211	1,322	1,476
Weighted average lease term (yrs)	5.2	4.8	5.3	5.4	5.4
Occupancy rate (%)	99.6	99.6	99.9	99.3	99.0
Number of properties	84	83	92	94	94
NTA per share (NZ$)	1.41	1.61	1.63	1.78	2.06

Figure 1. FY19 result summary (NZ$m)

Financial period 12 months ending	FY18 12/18	FY19 12/19	Change pcp	Forecast	Var	Comments
Underlying profit & loss (NZ$000s)						
Net income	76,090	79,787	4.9%	79,091	0.9%	In line
Base corporate costs	(4,669)	(5,283)	13.2%	(4,525)	16.7%	
EBITDA	71,411	74,679	4.6%	74,341	0.5%	
Net interest	(18,760)	(19,000)	1.3%	(19,676)	-3.4%	
PBT	52,651	55,679	5.8%	54,665	1.9%	
Current tax	(10,880)	(13,106)	20.5%	(11,704)	12.0%	Effective tax rate of 23%
NPAT (underlying)	41,769	42,573	1.9%	42,960	-0.9%	In line
Amortisation of incentives and other	2,340	2,644	13.0%	2,500	5.7%	
Funds from operations (FFO)	44,109	45,217	2.5%	45,461	-0.5%	
Maintenance capex	(4,476)	(3,446)	-23.0%	(4,050)	-14.9%	Very low, signalling 30–35 bpts for FY20
Tenant incentives, leasing fees and other	(2,436)	(2,943)	20.8%	(2,500)	17.7%	
Adjusted funds from operations	37,197	38,828	4.4%	38,910	-0.2%	
NPAT underlying	41,769	42,573	1.9%			
Investment property revaluations	66,370	125,193	88.6%			FY20 reval of 9.3%
Other non-operating adjustments	1,955	8,520	335.8%			
NPAT (reported)	110,094	176,286	60.1%			
Weighted shares on issue (000s)	**498,723**	**498,723**	**-**	**498,723**	**-0.0%**	
NPAT (Forbar) per share (cps)	8.38	8.54	1.9%	8.61	-0.9%	
FFO per share (cps)	8.84	9.07	2.5%	9.12	-0.5%	
AFFO per share (cps)	7.46	7.79	4.4%	7.80	-0.2%	Lower Maintenance capex
Dividends (cps)	7.55	7.60	0.7%	7.60	-	
Pay-out (NPAT)	90%	89%	-1.2%	88%	0.9%	
Pay-out (FFO)	85%	84%	-1.8%	83%	0.5%	
Pay-out (AFFO)	101%	98%	-3.6%	97%	0.2%	Targeting 95–100% AFFO payout %
Operating cash flow	53.75	48.37	-10.0%			Payment of cash tax in FY19
Gearing (Loan-to-value ratio)	30%	28%	-6.9%			
NTA	1.77	2.03	14.7%			Strong reval gain

Source: Forsyth Barr analysis

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Investment Summary

Property for Industry (PFI) has continued its track record of reliable and steady performance underpinned by a clear, low risk strategy. PFI's large industrial portfolio is centred on the key precincts in Auckland, and it is well positioned to continue to deliver its defensive attributes. Revaluation gains have been strong, driven by significant cap rate firming. NEUTRAL.

Business quality

- **Property fundamentals:** PFI has occupancy of 99% and a WALT of 5.4 years. A deep occupier market and change of use optionality over the medium term provides defensive attributes for the industrial market.
- **Defensive qualities:** Industrial property has a very stable earnings profile and has been resilient through the cycle. Over 80% of PFI's portfolio is weighted to Auckland with record low vacancy and strong tenant demand.

Earnings and cashflow outlook

- **Transactional activity:** PFI has ~NZ$80m of uncommitted debt capacity. We expect PFI will continue to be opportunistic with respect to acquisitions.
- **Development activity:** PFI has ~NZ$26m of value-add strategies committed for 2020.

Financial structure

- **Balance sheet capacity plus an intention to recycle more assets:** Balance sheet is solid at 28% geared, well below the 50% banking covenant limit and its self-imposed 40% maximum. PFI has a well diversified debt book with four banks in its syndicate and two issued bonds, and continues to divest non-core property.

Risk factors

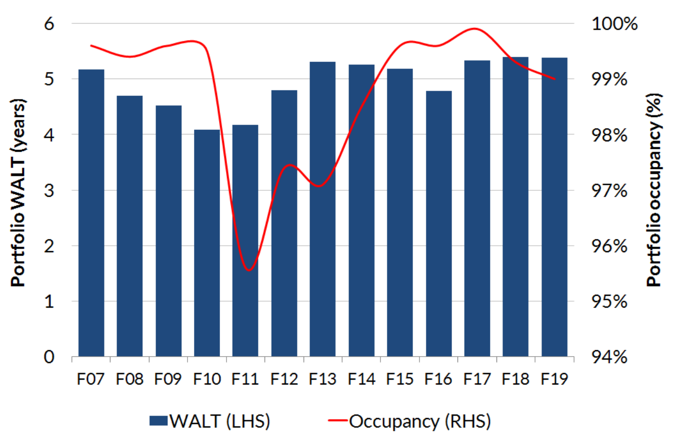
- **Rising interest rates**: Higher interest rates make other yield investments more attractive relative to listed property dividend yields.

Figure 2. Sector and portfolio exposure

	Auckland	Other North Island	South Island	Total
Industrial	70%	12%	5%	**87%**
Office	7%	0%	0%	**7%**
Mixed use	5%	1%	0%	**6%**
Total	**83%**	**13%**	**5%**	**100%**

Source: Forsyth Barr analysis, Company Reports

Figure 3. Portfolio Metrics



Source: Forsyth Barr analysis, Company Reports

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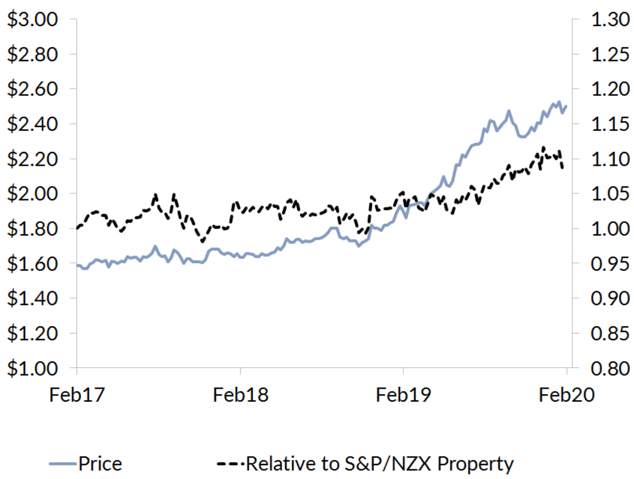
Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

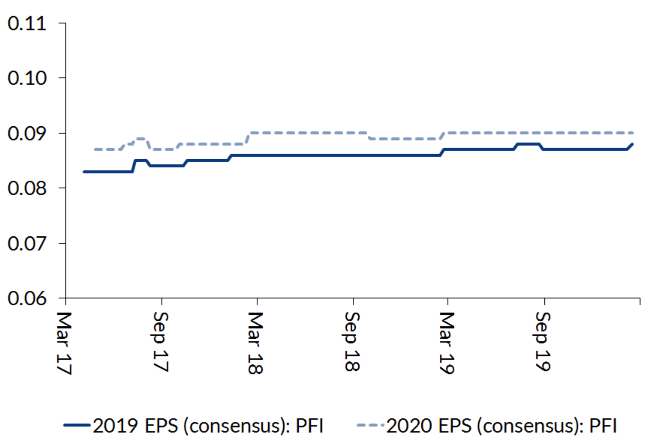
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect PFI's balance date - December)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Property For Industry	**PFI NZ**	**NZ$2.50**	**NZ$1,247**	**28.5x**	**28.5x**	**22.2x**	**22.0x**	**22.2x**	**22.0x**	**3.1%**
Argosy Property *	ARG NZ	NZ$1.43	NZ$1,179	20.9x	20.7x	18.9x	17.7x	18.9x	17.7x	4.4%
Goodman Property Trust *	GMT NZ	NZ$2.33	NZ$3,222	33.9x	32.8x	27.8x	26.0x	27.8x	26.0x	2.9%
Investore *	IPL NZ	NZ$1.83	NZ$557	22.3x	21.9x	21.3x	21.1x	21.3x	21.1x	4.2%
Kiwi Property Group *	KPG NZ	NZ$1.55	NZ$2,432	21.6x	21.4x	19.8x	18.9x	19.8x	18.9x	4.7%
Asset Plus *	APL NZ	NZ$0.61	NZ$98	16.5x	17.2x	12.4x	12.5x	12.4x	12.5x	6.0%
Precinct Properties NZ *	PCT NZ	NZ$1.88	NZ$2,463	27.8x	27.8x	24.6x	22.7x	24.6x	22.7x	3.4%
Stride Property *	SPG NZ	NZ$2.37	NZ$866	21.7x	21.1x	19.8x	19.0x	19.8x	19.0x	4.4%
Vital Healthcare *	VHP NZ	NZ$2.86	NZ$1,294	28.4x	27.4x	23.5x	21.8x	23.5x	21.8x	3.1%
			Compco Average:	**24.1x**	**23.8x**	**21.0x**	**20.0x**	**21.0x**	**20.0x**	**4.1%**
EV = Current Market Cap + Actual Net Debt			**PFI Relative:**	**18%**	**20%**	**6%**	**10%**	**6%**	**10%**	**-24%**

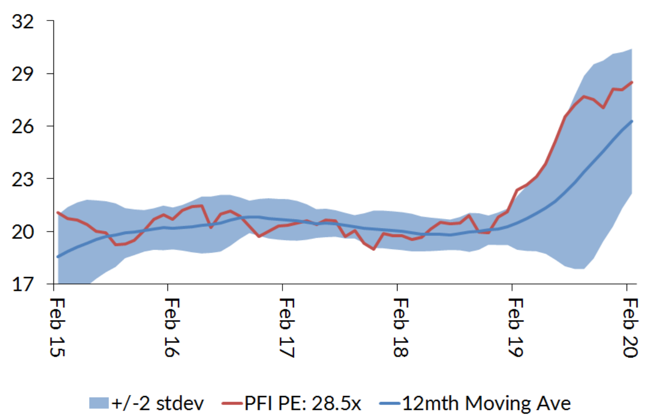
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (PFI) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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